



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	05/29/03	Bill No:	ACA 17
Tax:	Bradley-Burns	Author:	Daucher
Board Position:		Related Bills:	AB 1065 (Longville) AB 1221 (Steinberg/ Campbell) AB 680 (Steinberg, 2002) AB 2878 (Wiggins, 2002)

BILL SUMMARY

Among its provisions, this bill would authorize a city or a county to irrevocably elect to increase its property tax revenue by an amount equal to its local sales and use tax revenue attributable to a rate of 0.50 percent, and would require that the county's Educational Revenue Augmentation Fund (ERAF) be reduced by the same amount. The cities' and counties' local sales and use tax revenues attributable to a rate of 0.50 percent would be used to backfill the counties' ERAF.

Although this bill affects property tax and sales and use tax, this analysis will deal primarily with the sales and use tax provisions. The property tax provisions will be discussed generally only because it is related to the sales tax provisions in this bill, but it is not within the scope of administration by the Board.

Summary of Amendments

Since the April 28 introduced version of the bill, the amendments delete provisions related to modifying the property tax revenue and local sales tax revenue allocations beginning in the fiscal year 2009-10.

ANALYSIS

Current Law

Sales and Use Tax

The Sales and Use Taxes Law (commencing with Section 6001 of the Revenue and Taxation Code) provides that a sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased from a retailer. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless specifically exempted or excluded from the tax.

Currently, the state sales and use tax and local tax rate is 7.25 percent. Of the 7.25 percent base rate, 6 percent is the state portion and 1.25 percent is the local portion. The components of the state sales and use tax rate of 6 percent are as follows:

- 4.75 percent state sales and use tax is allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051 and 6201 of the Revenue and Taxation Code);

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- 0.50 percent state tax is allocated to the Local Revenue Fund which is dedicated to local governments to fund health and welfare programs (Sections 6051.2 and 6201.2 of the Revenue and Taxation Code);
- 0.25 percent is an additional state sales and use tax allocated to the state's General Fund which is dedicated for state general purposes (Sections 6051.3 and 6201.3 of the Revenue and Taxation Code);
- 0.50 percent state tax is allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

The Bradley-Burns Uniform Local Sales and Use Tax Law (commencing with Section 7200 of the Revenue and Taxation Code) authorizes counties and cities to impose a local sales and use tax. The rate of tax is fixed at 1.25 percent of the sales price of tangible personal property sold at retail in the county, or purchased outside the county for use in the county. All counties and cities within California have adopted ordinances under the terms of the Bradley-Burns Law.

Under the Bradley-Burns Law, the 0.25 percent tax rate is earmarked for county transportation purposes, and 1 percent may be used for general purposes. Cities are also authorized to impose a sales and use tax rate of up to 1 percent, which is credited against the county rate so that the combined local tax rate under the Bradley-Burns Law does not exceed 1.25 percent.

Additionally, under Bradley-Burns Law, a city, county, or city and county imposing a local sales and use tax is required to contract with the Board to administer the local sales and use tax. The Board is required, at least twice during each calendar quarter, to transmit the local sales and use tax revenues to the city, county, or city and county.

Property Tax

Prior to Proposition 13, each local government with taxing powers (counties, cities, schools, and special districts, etc.) could levy a property tax on the property located within its boundaries. Each jurisdiction determined its tax rate independently (within certain statutory restrictions) and the statewide average tax rate prior to Proposition 13, under this system, was 2.67 percent. After Proposition 13, the property tax rate was limited to a maximum of one percent of a property's assessed value.

Since local jurisdictions could no longer set their own individual tax rates and instead were required to share in a pro rata portion of the maximum one percent tax rate, the Legislature was given the authority to determine how the property tax revenue proceeds should be allocated. The legislation that established the current property tax allocation system, found in Revenue & Taxation Code Sections 95 - 99.2, was Assembly Bill 8 (Stats. 1979, Ch. 282, L. Greene). The descriptive term for the allocation procedure for locally assessed property tax revenues is still commonly referred to as "AB 8," some twenty years later.

In addition to establishing allocation procedures, AB 8 also provided financial relief to local agencies to offset most of the property tax revenue losses incurred after Proposition 13. AB 8 provided relief in two ways: first, it reduced certain county health and welfare program costs and, second, it shifted property taxes from schools to cities, counties and special districts, replacing the school's lost revenues with increased

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General Fund revenues. (There were six counties - Alpine, Lassen, Mariposa, Plumas, Stanislaus, and Trinity – referred to as “negative bailout” counties, where the amount of property taxes allocated to the county was *reduced* because the health and welfare components of AB 8 were so favorable to those counties.)

In 1992, the ERAF, was established. ERAF partially reversed the relief provided to local agencies by AB 8. The effect of ERAF was to redirect a portion of property tax revenues previously allocated to cities, counties, and special districts to schools, thus reducing the state’s General Fund obligations for funding schools under Proposition 98.

Proposed Law

This bill would add Sections 29.5 and 36 to Article XIII of the California Constitution to do the following:

- 1) On and after July 1, 2004, a city or a county may, by a majority vote of its governing body on or before June 1 of the preceding fiscal year, irrevocably elect an increase in the total amount of property tax revenue allocated to the city or county (allocation based on prior fiscal year amounts) by the respective "city equivalent tax amount" or the "county equivalent tax amount." The total amount of property tax revenue allocated to the county's ERAF by an electing county or a county in which an electing city is located would be reduced by the "countywide equivalent amount."
- 2) On August 15, 2005, and on the 15th of each month thereafter, the Board shall transmit to the ERAF of the county in which the electing city is located that portion of the city's local sales tax revenue (based on the preceding month) attributable to a local sales tax rate of 0.50 percent. On August 15, 2005, and on the 15th of each month thereafter, the Board shall transmit to the electing county's ERAF that portion of the county's local sales tax revenue (based on the preceding month) attributable to a local sales tax rate of 0.50 percent in the unincorporated areas of the county.
- 3) Define "city equivalent amount", "county equivalent amount", and "county adjustment amount" as follows:
 - A city equivalent amount means an amount of property tax revenue that is equal to that portion of the city's local sales tax revenue under the Bradley-Burns Uniform Local Sales and Use Tax Law, that is attributable to a local sales tax rate of 0.50 percent.
 - A county equivalent amount means an amount of property tax revenue that is equal to that portion of the county's local sales tax revenue under the Bradley-Burns Uniform Local Sales and Use Tax Law, that is attributable to a local sales tax rate of 0.50 percent in the unincorporated areas of the county.
 - A countywide equivalent tax amount means an amount equal to the sum of the city equivalent amount and the county equivalent amount.
- 4) If an ERAF is discontinued in a county, as directed or authorized by law, and no successor to that fund is established, both of the following would apply: (1) any increase in property tax revenues resulting from the provisions of this bill would be exclusively funded by reducing the total property tax revenues that are otherwise allocated to school entities in the county; and (2) the Board would transmit the local sales and use tax revenues as provided under the provisions of this bill to the county auditor for allocation to school entities in the county in the same proportion to the total amount of property tax revenues that are otherwise allocated to school entities in that county.

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- 5) The Legislature may not enact a statute that would reduce the total amount of property tax revenue allocated to an electing city or county. Additionally, the Legislature may not enact a statute that would either eliminate the authority of a city or a county to impose a local sales and use tax, or reduces the 1 and 1.25 percent in the case of a county or the 1 percent in the case of a city, the maximum local sales and use tax rate that a city or county may impose.

Background

"The fiscalization of land use" refers to the concept of examining land use decisions in the context of their revenue and expenditure consequences. Because Proposition 13 reduced the revenues that would be received from property taxes from any particular development (industrial, commercial, or residential), local jurisdictions began to pay even more attention to the fiscal outcomes of land use decisions, and those uses that generated revenues in addition to property taxes have been elevated in importance.

The decision by local governments to utilize land for retail sales in order to generate sales tax revenues is one example of the fiscalization of land use. Local governments have engaged in numerous activities to encourage retail activity in their jurisdictions, such as zoning excessively for retail, providing sales tax rebates to retailers who locate in their jurisdictions, waiving developer fees, and expediting the permit process.

This bill is intended to address, among other issues, the fierce competition that local entities are now facing in getting as much local (1.0%) sales and use tax revenue as they can.

Two bills introduced during the 2001-2002 Legislative Session contained provisions pertaining to local tax allocations. Assembly Bill 680 (Steinberg) would have changed the allocation method of the 1 percent local sales tax in El Dorado, Placer, Sacramento, Sutter, Yolo, and Yuba counties. Assembly Bill 2878 (Wiggins) would have modified the property tax allocation to a city or county, provide that a city may not impose a sales and use tax rate in excess of 0.85% except under specified circumstances, and prohibit the state from transferring money from the General Fund to cities and counties to fund vehicle license fee offsets.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author in an effort to provide constitutional protection for cities' and counties' property tax and sales tax revenues. According to Assembly Member Daucher's staff, ACA 17 would allow cities and counties to make better land decisions while also reducing their reliance on sales tax revenues.
2. **Summary of May 29 amendments.** Amendments to this bill deleted the provisions related to modifying the property tax revenue and local sales tax revenue allocations beginning in the fiscal year 2009-10. The introduced version of the bill (dated April 28, 2003) added Section 29.7 to Article XIII of the Constitution to provide new property tax revenue and local sales and use tax revenue allocations.

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3. **The Board does not have the information necessary to transmit to the county's ERAF that portion of the electing city's or county's local sales and use tax revenue attributable to a local tax rate of 0.50 percent.** This bill provides that on August 15, 2005, and the 15th of each month thereafter, the Board shall transmit to the county's ERAF that portion of the electing city's or county's local sales and use tax revenue (based on the preceding month) attributable to 0.50 percent. The Board administratively cannot do this because it does not have this information by the 15th of each month. The following explains.

Taxpayers file sales and use tax returns on a monthly, calendar quarterly, calendar yearly, and fiscal yearly basis. Monthly tax returns are filed on or before the last day of the month following the month for which the tax is due (e.g., tax returns for the month of March must be filed on or before April 30). Quarterly tax returns are filed on or before the last day of the next month succeeding each quarterly period (e.g., tax returns for the first quarter, January through March, must be filed on or before April 30). Yearly tax returns are filed on or before the last day of the month following the end of the year for which the tax is due. For taxpayers whose reporting year ends December 31, the return should be filed on or before January 31 of the following year. Taxpayers reporting on a fiscal year basis (fiscal year ending June 30), are required to file their returns on or before the last day of the month following the close of the fiscal year, July 31.

The majority of taxpayers file on a quarterly basis. Taxpayers filing on a quarterly basis generally make two prepayments. The first prepayment is due on or before the 24th day of the month following the first month of the quarter. The second prepayment is due on or before the 24th day of the month following the second month of the quarter. Taxpayers complete a prepayment form and the prepayment amount is based on 90 percent of the tax liability for the month. However, this prepayment form does not contain any local tax allocation information.

The Board makes a local tax payment to cities and counties once a month (the Board is required by statute to transmit local sales and use tax revenues to local jurisdictions at least twice in each calendar quarter). For quarterly tax revenues, the Board computes local tax payments using the prior year's like quarterly tax allocation as a starting point, and eliminates nonrecurring transactions such as fund transfers (misallocations of local tax), audit payments and refunds, and then adjusts for growth. The Board disburses this amount to each local jurisdiction in three monthly installments called "advances" prior to the final computation of the quarterly tax return. The first and second advances each represent 30 percent of the distribution, while the third advance represents 40 percent. One advance payment is made each month, and the quarterly reconciliation payment, called the "clean-up" payment, is distributed in conjunction with the first advance payment for the subsequent quarter.

The "clean-up" payment is the reconciliation between the total of the three advance payments and the actual collections (less the Board's administrative costs) for any given quarterly return period. The clean-up payment also includes adjustments from audits, refunds, amended returns, and other taxpayer reporting errors identified by Board staff (e.g., Return Analysis Section and Local Revenue Allocation Section).

For calendar year 2003, warrants for advances and/or clean-up payments are mailed by the State Controller's Office for deposit under the State Controller's Same-

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Day Banking program. These dates are January 15th, February 19th, March 26th, April 16th, May 21st, June 27th, July 16th, August 20th, September 26th, October 15th, November 19th, and December 26th.

Additionally, the Department of Motor Vehicles (DMV) and the Department of Housing and Community Development (HCD) collect use tax on vehicles and vessels (DMV) and mobile homes and commercial coaches (HCD) for the Board. The DMV transmits use tax revenues to the Board on a daily basis. The HCD transmits use tax revenues to the Board on a quarterly basis. Allocation information for both agencies' collections is transmitted to the Board on the same daily/quarterly basis.

Based on the preceding time lines, the Board does not have the information regarding the amounts of cities' and counties' local sales and use tax revenues in the immediate prior month by the 15th of the next month. Therefore, the Board cannot transmit on the 15th of each month to the county's ERAF that portion of the electing city's or electing county's local sales and use tax revenue attributable to a rate of 0.50 percent.

Board staff suggests that the bill be amended to provide that payments would be made to the county's ERAF at the same time that payments are made to the local jurisdictions. Board staff is willing to work with the author's office in drafting amendments to the bill that would address these issues.

4. **Suggested amendment.** In several subdivisions of the bill, references are made to a "city's sales tax revenue" and a "county's sales tax revenue." The Bradley-Burns local tax is a sales and use tax. Sales and use taxes are complementary taxes, i.e., when one tax applies, the other does not. The sales tax is imposed on the sale of tangible personal property in California and the use tax is imposed on the purchase for storage, use, or other consumption in California. Therefore, the language should specify that it is the city's and county's "sales and use tax revenues." Without this correction, the city's and county's local use tax revenue will not apply to the provisions of this bill. Board staff is willing to work with the author's office in drafting amendments to the bill to address this matter.
5. **Electing cities and counties may be required to adopt a resolution or a new ordinance.** Current law imposes a local tax at a rate of 1.25 percent in a county. A city may impose a local tax up to 1 percent, which is credited against the 1.25 percent tax in the county. Cities, counties, and redevelopment agencies must adopt an ordinance to impose a local tax, which outlines what rate the local jurisdiction receives. Many of the cities receive the full 1 percent allowed under current law, but some cities reach agreement with the county to take a smaller amount. For example, Angels Camp (0.88 percent), Hayward (0.95 percent), and Santa Rosa (0.975 percent) are some of the many cities that are allocated less than 1 percent.

This bill could require an electing city and county to adopt new ordinances reflecting the amounts of local sales and use tax revenues attributable to 0.50 percent that would be transmitted to the county's ERAF. For cities making an election that receive less than 1 percent, 0.50 percent would be transmitted to the ERAF of the county in which the city is located, and the remaining amount would be transmitted to the city. For example, Angels Camp under its existing tax ordinance, receives 0.88 percent. If Angels Camp made an election, local sales and use tax revenues

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attributable to 0.50 percent would be transmitted to the ERAF of the county in which Angels Camp is located and the remaining amount of 0.38 percent (0.88 - 0.50) would be transmitted to Angels Camp.

As an alternative, depending on the form in which the bill is enacted, it is possible that the cities and counties electing to join the program may pass resolutions authorizing the Board to pay amounts attributable to a 0.50 percent rate to the county ERAF. This procedure was used to allow the counties to request allocations from the Local Public Safety Fund in 1993. The Board's Legal Staff will have to make the determination of the applicable procedure.

6. **Even though the local sales and use tax revenues transmitted to an electing city or county would be reduced, the Board's administrative costs would remain the same.** Existing law requires the Board to charge local entities for the services it provides in administering the local entity's tax ordinance. The amount to be charged is determined by the Board with the concurrence of the Department of Finance based on the local entity's total computed cost, including direct, shared, and central agency costs. These costs are deducted on a quarterly basis from the amount of local taxes collected by the Board and transmitted to local jurisdictions.

This bill would require the Board to transmit to the county's ERAF that portion of the city's or county's local sales and use tax revenues attributable to a local sales and use tax rate of 0.50 percent. This effectively reduces the amount of local sales and use tax revenue that a city or county receives by at least one-half. However, the Board's administrative costs would remain the same. As a result, the ratio of administrative costs to local tax revenues would essentially double.

7. **Related legislation. AB 1065 (Longville)** would authorize a county to impose a local sales and use tax rate of either 1.25 percent or 1.50 percent. **AB 1221 (Steinberg and Campbell)**, among other things, would: (1) prohibit a city from imposing a local sales and use tax at a rate not to exceed 0.50 percent; (2) prohibit a county from imposing a local sales and use tax rate at a rate not to exceed 0.75 percent; and (3) increase the amount of property tax revenue allocated to a county or city by that county or city's reimbursement amount, as defined, and correspondingly decrease the amount of property tax revenue allocated to a county's Educational Revenue Augmentation Fund by the countywide adjustment amount, as defined. AB 1221 also contains double-joining language providing that AB 1221 would become effective only if the proposed ACA bill is approved by the voters. The proposed ACA bill would impose an additional sales and use tax at a rate of 0.50 percent for allocation to school entities, as specified. The proposed ACA bill would also establish the State School Assistance Fund for Education in the State Treasury and a School Assistance Fund for Education (SAFE) in each county to receive revenues derived from the proposed additional sales and use tax, as provided.

COST ESTIMATE

Modifying the local sales and use tax revenues that an electing city and county would receive would require every electing city and county to adopt a new ordinance and a new contract with the Board. Programming and data entry would also be necessary to

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modify the Fund Distribution System to account for amounts allocated to the various cities and counties. A detailed cost estimate is pending.

REVENUE ESTIMATE

Background, Methodology, and Assumptions

The Bradley-Burns Uniform Local Sales and Use Tax Law authorizes a county to impose a local sales and use tax at a rate of 1.25 percent. Similarly, the law authorizes a city, located within a county imposing such a tax rate, to impose a local sales tax rate of 1 percent that is credited against the county rate.

This bill would authorize a city or county to irrevocably elect an increase in its ad valorem property tax revenue by an amount equal to its local sales and use tax revenue attributable to a rate of 0.50 percent, and would require that the county's ERAF be reduced by the same amount. The electing cities' and counties' local sales and use tax revenues attributable to a rate of 0.50 percent would be used to backfill the counties' ERAF.

In fiscal year 2001-02, city and county revenue from the Bradley-Burns 1 percent sales and use tax rate amounted to \$4.4 billion. Reducing this amount to 0.50 percent would reduce an electing city's and county's Bradley-Burns sales and use tax revenue by \$2.2 billion.

Analysis prepared by:	Debra A. Waltz	324-1890	06/05/03
Revenue estimate by:	Dave Hayes	445-0840	
Contact:	Margaret S. Shedd	322-2376	
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